

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Request for Review by Puerto Rico	)	WC Docket No. 08-71
Telephone Company of Decision of the	)	
Universal Service Administrator	)	

**PUERTO RICO TELEPHONE COMPANY'S REQUEST FOR REVIEW OF  
DECISION OF THE UNIVERSAL SERVICE ADMINISTRATOR**

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**I. STATEMENT OF ISSUES AND INTEREST**

Pursuant to Sections 54.719, 54.721, and 54.722 of the Federal Communications Commission's ("Commission" or "FCC") rules,<sup>1</sup> Puerto Rico Telephone Company ("PRT") seeks review of the Universal Service Administrative Company's ("USAC") Management Response to Audit Report HC-2009-FL-041, Follow-up Audit to HC-2007-299, which purports to evaluate PRT's compliance with the Federal High Cost Universal Service program for the period from July 1, 2006 to June 30, 2007.<sup>2</sup>

Specifically, PRT urges the Commission to reverse USAC's legally infirm decision that PRT was "overpaid" \$568,540 in Interstate Common Line Support ("ICLS") because PRT allegedly failed to comply with the Commission's continuing property record ("CPR") rules.<sup>3</sup> The Commission should reverse USAC's decision because: (1) USAC and the auditor

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<sup>1</sup> 47 C.F.R. §§ 54.719, 54.721, and 54.722.

<sup>2</sup> See Appendix A (Puerto Rico Telephone Company (SAC Number: 633201) – Performance Audit for the Universal Service Fund Disbursements During the Twelve-Month Period Ended June 30, 2007, prepared by KPMG LLP) ("KPMG Audit Report"); Appendix B (Letter from Craig Davis, USAC, to Robert Figenschier, PRT (Oct. 5, 2010)) ("USAC Oct. 5<sup>th</sup> Letter").

<sup>3</sup> USAC's October 5<sup>th</sup> Letter refers to seeking recovery from PRT in the amount of \$568,540 for the alleged overpayment of ICLS, while USAC's Management Response to the audit indicates that USAC will recover \$572,168 from PRT for high cost support.

retroactively apply a document retention rule effective in January 2008 to CPR practices from 2004; (2) any failure by PRT to maintain CPR records does not establish that PRT was overpaid ICLS, and USAC's determination to the contrary is inconsistent with Section 254(e) of the Communications Act and Sections 54.7 and 54.904(a) of the Commission's rules, which only require a universal service recipient to use the funding "for the provision, maintenance, and upgrading of facilities *and services* for which the support is intended";<sup>4</sup> and (3) USAC's audit inappropriately goes beyond assessing the veracity of data provided by PRT as required by USAC Forms 507, 508, and 509 for purposes of ICLS support distribution. Accordingly, the Commission should reverse USAC's decision.

## **II. STATEMENT OF FACTS**

PRT is an incumbent local exchange carrier providing service in Puerto Rico. In 2009, USAC retained KPMG LLP ("KPMG") to audit PRT's compliance with the applicable rules and orders governing disbursements of high cost support made to PRT from July 1, 2006 through June 30, 2007.<sup>5</sup> KPMG's work was performed from November 2, 2009 to June 10, 2010, and its results are as of June 10, 2010. In KPMG's Audit Report, it alleged that PRT failed to retain sufficient documentation of its *assets*, which, according to KPMG, meant that PRT had been overpaid \$572,168 in ICLS.<sup>6</sup>

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<sup>4</sup> See 47 U.S.C. § 254(e); 47 C.F.R. §§54.7 and 54.904(a) (emphasis added).

<sup>5</sup> The High Cost support received by PRT during the twelve-month period ended June 30, 2007, was based on the following annual financial and operational data submitted by PRT to NECA and USAC: (1) 2004 FCC Form 509, based on calendar year 2004 data; (2) FCC Form 507 with loop data for the 2004 calendar year; and (3) FCC Form 508, based on projected financial data for the program year beginning July 1, 2006 through June 30, 2007.

<sup>6</sup> Appendix A (KPMG Audit Report at 4).



In making this determination, KPMG reviewed 40 asset samples from the material accounts identified in PRT's 2004 Form 509; assets that were in service as of December 31, 2004.<sup>7</sup> Out of the 40 assets, KPMG alleged that PRT "was unable to provide sufficient supporting documentation for 19."<sup>8</sup> KPMG also alleged that PRT "was only able to provide partial support for 7 of the 40 assets selected for testing."<sup>9</sup> Based on this information, KPMG "estimate[d]" that ICLS support to PRT for the "twelve-month period ended June 30, 2007 w[as] potentially overstated by \$572,168 as the amounts originally reported could not be supported."<sup>10</sup> KPMG's Audit Report failed to explain: (i) how this amount was calculated; (ii) how PRT's conduct violated the Commission's rules in place during 2004; or (iii) how PRT's failure to comply with rules that were not in effect for universal service support purposes translates into an over-recovery of ICLS.<sup>11</sup>

*USAC High Cost Management Response.* On June 30, 2010, USAC issued its written response to KPMG's recommended findings. At bottom, USAC concurred with the auditor and concluded that PRT "does not have documentation consistent with the Part 32 rules necessary to

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<sup>7</sup> *Id.* at n.1.

<sup>8</sup> *Id.* at 12.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 1-2. In the June 2010 final report, KPMG also alleged that PRT did not maintain Continuing Property Record ("CPR") details, as of December 31, 2004, in sufficient detail for the following accounts: General Support Facilities (Account 2110); Central Office Switching Equipment (Account 2210); Central Office Transmission Equipment (Account 2230); Cable and Wire Facilities (Account 2410). KPMG concluded, however, that there "is no monetary impact of the finding on the high cost disbursements received by the Beneficiary during the twelve-month period ended June 30, 2007." *Id.*

<sup>11</sup> Without further explanation, KPMG cites to an ICLS record retention rule that did not become effective until 2008 (47 C.F.R. § 54.202(e)), as well as two accounting rules (47 C.F.R. §§ 32.12(a),(b), 32.2000(e)(2)) that do not govern the high cost program or inform USAC's audit authority.

support account data reported in its filings with the National Exchange Carrier Association and USAC.”<sup>12</sup> Accordingly, USAC concluded that it “will recover High Cost support in the amount of \$572,168” from PRT.<sup>13</sup>

*USAC September 28, 2010 Letter to PRT.* On September 28, 2010, USAC sent PRT a letter that contained the final report from KPMG, as well as the USAC High Cost Management Response.<sup>14</sup>

*USAC October 5, 2010 Letter to PRT.* On October 5, 2010, USAC sent PRT a letter explaining that “as is USAC’s policy with adverse or disclaimer opinions, [KPMG’s] follow-up audit was required to quantify the monetary effect of audit HC-2007-299 conducted by KPMG LLP.”<sup>15</sup> According to USAC, the “effect quantified will result in a recovery of \$568,540 of Interstate Common Line Support for SAC 633201.”<sup>16</sup> USAC noted that it “will recover these funds from [PRT’s] December 2010 High Cost support payment, which will be disbursed at the end of January 2011.”<sup>17</sup>

### **III. STATEMENT OF LAW**

The record-keeping requirements applicable to recipients of ICLS and USAC’s ICLS audit authority—as set forth in Section 54 of the Commission’s rules—changed dramatically as of January 23, 2008. Prior to that date, as described below, the FCC’s rules did not require ICLS

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<sup>12</sup> Appendix A (KPMG Audit Report at 1).

<sup>13</sup> *Id.*

<sup>14</sup> Appendix C (Letter from High Cost Program Management, USAC, to PRT, regarding “Results of the Follow-Up Audit to the 2007-2008 FCC OIG Audit” (Sept. 28, 2010)).

<sup>15</sup> Appendix B (USAC October 5<sup>th</sup> Letter at 1).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

recipients to maintain specific documents and only granted USAC vague authority to audit the veracity of ICLS data submitted to USAC.

Although the Commission began in 2002 to add specific recordkeeping requirements for various aspects of the USF, *it did not publicly consider such requirements for ICLS or any high-cost program until 2005*. And it was not until January 23, 2008 that a specific document retention rule for recipients of high cost funding took effect. This rule—detailed below—requires the retention for five years of particular documentation, including data supporting line count filings, historical customer records, fixed asset property accounting records, general ledgers, invoice copies for the purchase and maintenance of equipment, and maintenance contracts for the upgrade of equipment. *Importantly, no such rule was in effect in 2004, the period during which PRT allegedly failed to maintain the records necessary to justify its receipt of ICLS.*

**A. 47 C.F.R. § 54—The FCC’s USF Document Retention Rules**

Although other universal service support mechanisms have had specific regulatory recordkeeping requirements since 2002, *the Commission did not impose such a requirement on recipients of ICLS until 2008*. For instance, the FCC amended its rules in December 2002 to require contributors to universal service support to “maintain records and documentation to justify information reported ... , including the methodology used to determine projections, for three years and ... provide such records and documentation to the Commission or [USAC] upon request.”<sup>18</sup> In December 2003, the FCC similarly amended its rules to require health care providers receiving universal service support to “maintain for their purchases of services supported ... documentation for five years from the end of the funding year sufficient to

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<sup>18</sup> *Federal-State Joint Board on Universal Service*, 67 Fed. Reg. 79525, 79533 (Dec. 30, 2007) (codified at 47 C.F.R. § 54.711(a)).

establish compliance with all rules.”<sup>19</sup> The Commission specified that such “[d]ocumentation must include, among other things, records of allocations for consortia and entities that engage in eligible and ineligible activities, if applicable.”<sup>20</sup>

However, not until June 2005 did the FCC seek comment—in the context of a comprehensive USF notice of proposed rulemaking—on whether to “adopt document retention rules for all of the USF mechanisms.”<sup>21</sup> The agency finally promulgated such retention rules in August 2007, “requir[ing] that information necessary to determine compliance with th[e] Commission’s rules and regulations be available to [USAC], its auditors, and Commission personnel upon request, *for all USF programs*.”<sup>22</sup> With respect to the high-cost program, which includes ICLS, the FCC amended section 54.202 of its rules to provide that “[a]ll eligible telecommunications carriers . . . retain [for at least five years from the receipt of funding] all records required to demonstrate to auditors that the support received was consistent with the universal service high-cost program rules.”<sup>23</sup> The agency specified that such “records should include the following: data supporting line count filings; historical customer records; fixed asset property accounting records; general ledgers; invoice copies for the purchase and maintenance of

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<sup>19</sup> *Rural Health Care Support Mechanism*, 68 Fed. Reg. 74492, 74503 (Dec. 23, 2003) (codified at 47 C.F.R. § 54.619(a)).

<sup>20</sup> *Id.*

<sup>21</sup> *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, 20 FCC Rcd 11308, ¶ 83 (2005) (“*Program Management NPRM*”).

<sup>22</sup> *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, Report and Order, 22 FCC Rcd 16372, ¶ 23 (2007) (“*Program Management Report and Order*”) (emphasis added).

<sup>23</sup> *Measures to Safeguard the Universal Service Fund from Waste, Fraud, and Abuse as well as Measures to Improve the Management, Administration, and Oversight of the Universal Service Fund*, 72 Fed. Reg. 54214, 54217-18 (Sept. 24, 2007) (codified at 47 C.F.R. § 54.202(e)).

equipment; maintenance contracts for the upgrade of equipment; and any other relevant documentation.”<sup>24</sup> *This amended rule took effect on January 23, 2008*, the date on which the Office of Management Budget gave its approval.<sup>25</sup>

In short, the record-keeping obligations of recipients of ICLS and the corresponding scope of USAC’s ICLS audit authority changed on January 23, 2008. With the new rule, ICLS recipients were required to maintain on a going-forward basis specific documentation, and USAC was authorized to audit a recipient of ICLS by requesting access to the documents required to be maintained pursuant 47 C.F.R. § 54.202(e).

**B. Legal Consequences for Failing to Produce the Specific Documents USAC Requested**

In an audit of ICLS payments, a recipient’s failure to maintain *documents that were not required to be maintained prior to January 23, 2008* is *not* a failure to comply with the FCC universal service rules. As explained above, prior to that date the Commission did not have any rules mandating the retention of particular records related to ICLS funding. The USF rules simply required that ICLS participants complete FCC Forms 507, 508, and 509 and submit a certification attesting to the accuracy of their filings.<sup>26</sup> Although the rules plainly permitted USAC to audit the veracity of the submitted ICLS data—including these forms—they did not authorize USAC to demand—or require ICLS recipients to retain—any specific document or

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<sup>24</sup> *Id.* at 54218.

<sup>25</sup> *See Comprehensive Review of the Universal Service Fund*, 73 Fed. Reg. 11837, 11837 (Mar. 5, 2008).

<sup>26</sup> The USF rules also required that a recipient certify pursuant to 54.904 “that all ICLS provided to such carrier will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.” 47 C.F.R. § 54.904.

category of documents.<sup>27</sup> Nor did the rules specify how long a recipient needed to retain such records. Prior to 2008, so long as an ICLS recipient provided an auditor with some form of evidence justifying its receipt of ICLS, the recipient complied with the FCC's rules.

Furthermore, section 254(e) of the Communications Act and FCC Rules 54.7 and 54.904(a) require a universal service recipient to use the funding “for the provision, maintenance, and upgrading of facilities *and services* for which the support is intended.”<sup>28</sup> Thus, the fact that an ICLS recipient may not retain relevant records regarding its assets does not mean that ICLS was improperly paid to the recipient. As detailed below, USAC's audit failed to grasp this important point or to even acknowledge that USF funding can be used for the provision of service and not just the build out and purchase of facilities.

#### IV. ARGUMENT

##### A. USAC's Application of Record-Keeping Requirements Made Effective by the Commission in 2008 to an Audit of Service Provided in 2004 Is Impermissibly Retroactive and Violates Due Process.

USAC's application of record-retention requirements made effective in 2008 to PRT's provision of service in 2004 is impermissibly retroactive and violates fundamental principles of due process. The APA limits “rules” to agency prescriptions of “future effect”<sup>29</sup> and prohibits

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<sup>27</sup> As for documents generated *after* January 23, 2008, the failure to produce specific documents—and in particular those documents listed in 47 C.F.R. § 54.202(e)—may be considered a rule violation subject to penalty even though the FCC was not explicit on that point in its order adopting the document retention rules. However, it does not necessarily follow that such a rule violation would result in the recipient losing universal service support

<sup>28</sup> See 47 U.S.C. § 254(e); 47 C.F.R. §§54.7 and 54.904(a) (emphasis added).

<sup>29</sup> 5 U.S.C. § 551(4). See also *NCTA v. FCC*, 567 F.3d 659, 670 (D.C. Cir. 2009) (highlighting the “APA's requirement that legislative rules ... be given future effect only” (internal quotation omitted)).

retroactive rules.<sup>30</sup> A rule is primarily retroactive<sup>31</sup> if it “impair[s] rights a party possessed when he acted, increase[s] a party’s liability for past conduct, or impose[s] new duties with respect to transactions already completed.”<sup>32</sup> Such rules are “categorical[ly] limit[ed],” *i.e.*, per se unlawful.<sup>33</sup> In addition, “[t]raditional concepts of due process incorporated into administrative law preclude an agency from penalizing a private party for violating a rule without first providing adequate notice of the substance of the rule.”<sup>34</sup>

USAC’s application of the record-keeping requirements that became effective in 2008 to PRT’s conduct in 2004 would be plainly retroactive.<sup>35</sup> Indeed, USAC has judged PRT’s conduct under a standard that was not in place during the period of service being audited. Specifically, USAC’s application of the 2008 standards to PRT’s 2004 conduct “impose[s] new duties with

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<sup>30</sup> See, e.g., *DIRECTV v. FCC*, 110 F.3d 816, 825-26 (D.C. Cir. 1997) (holding that “primarily retroactive” rules are per se unlawful under the APA); *Chadmoore Commc’ns, Inc. v. FCC*, 113 F.3d 235, 240 (D.C. Cir. 1997) (“[A] legislative rule may only be applied prospectively.”); see also *Bowen v. Georgetown Univ. Hosp.*, 448 U.S. 204, 216 (1988) (Scalia, J., concurring) (stating that the APA “does not permit retroactive application” of agency rules).

<sup>31</sup> See, e.g., *DIRECTV*, 110 F.3d at 825-26; see also, e.g., *Bergerco Canada v. U.S. Treasury Dep’t*, 129 F.3d 189, 192 (D.C. Cir. 1997) (“[T]here are two retroactivity limits in the APA: The first is a categorical limit, requiring express congressional authority and applying only in the domain of agency rules. The second limit is more elastic, governing all agency decisionmaking and involving the sort of balancing of competing values, both legal and economic, that often features in ‘arbitrary or capricious’ analysis and that has historically governed retroactivity considerations in the agency context.”).

<sup>32</sup> *DIRECTV*, 110 F.3d at 825-26 (quoting *Landgraf v. USI Film Prods.*, 511 U.S. 244, 280 (1994)).

<sup>33</sup> *Bergerco Canada v. U.S. Treasury Dep’t*, 129 F.3d 189, 192 (D.C. Cir. 1997).

<sup>34</sup> See, e.g., *Satellite Broad. Co. v. FCC*, 824 F.2d 1, 3 (D.C. Cir. 1987).

<sup>35</sup> PRT’s network planning and deployment have been driven by the USF support it has received. Based on the reasonable expectation that USAC *would not* seek to recover this money years later, PRT invested substantial sums of its own money to build out its network. With no analysis and minimal justification, all of which fails to pass scrutiny, USAC now proposes to take this money back. This squarely fits within the definition of retroactive rulemaking.

respect to transactions already completed,”<sup>36</sup> making it retroactive and thus unlawful. In addition, there can be no debate about whether PRT received “fair notice” that the 2008 record retention requirements would apply to its pre-2008 conduct<sup>37</sup> because PRT literally had *no* notice. In sum, applying the 2008 rules to earlier conduct would be blatantly retroactive and a denial of due process. Only for conduct after January 23, 2008 could USAC base audit findings on an ICLS recipient’s alleged failure to comply with the Commission’s record-keeping requirements for the high cost program.

USAC cannot sidestep this conclusion by relying on the Part 32 general accounting rules as the statutory basis for requiring a particular method of document retention. Section 32 addresses general accounting issues, not high cost auditing issues. Moreover, USAC’s authority derives from Part 54 (and to a lesser extent, Part 36), not Part 32.<sup>38</sup> Indeed, in the *2005 Program Management NPRM*—when the Commission first proposed specific document retention requirements for recipients of high cost support—the Commission explained “that our rules pertaining to the High Cost support mechanism are contained in both Part 36 and Part 54.”<sup>39</sup>

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<sup>36</sup> *DIRECTV*, 110 F.3d at 826.

<sup>37</sup> *Trinity Broad. of Fla. v. FCC*, 211 F.3d 618, 628 (D.C. Cir. 2000) (holding that “due process requires that parties receive fair notice before being deprived of property,” and applying that requirement to a denial of a renewal application for a Commission license).

<sup>38</sup> In its final report, KPMG erroneously tries to draw support from Section 32.2000(e), which provides that “basic property records must be ... maintained throughout the life of the property.” 47 C.F.R. § 32.2000(e)(2). But this provision does not control the high cost fund, high cost fund audits, or high cost fund record retention. Indeed, if the Commission viewed this rule as requiring comprehensive record retention for USF mechanisms—as KPMG alleges—then the Commission would not have adopted three separate orders from 2002-2007 specifying document retention rules for contributors, health care recipients, and HCP recipients.

<sup>39</sup> *Program Management NPRM* at ¶ 47; see also “The High Cost Program: Initial Statistical Analysis of Data from the 2006/2007 Compliance Audits,” Office of Inspector General, FCC, at 11 (Oct. 3, 2007) (noting that a recipient of high cost support that is subject to



The Commission has been clear what rules govern the high cost program. Even if USAC believed that this area of law was unclear—and interpreted Part 32 as empowering USAC to require that recipients maintain and provide specific documents as a condition to receiving ICLS—it is powerless to apply this interpretation to PRT. The Commission’s rules clearly provide: “*The Administrator may not make policy [or] interpret unclear provisions of the statute or rules ... Where the Act or Commission’s rules are unclear, or do not address a particular situation, the Administrator shall seek guidance from the Commission.*”<sup>40</sup> Here, USAC sought no guidance.<sup>41</sup>

**B. USAC’s Finding of Inadequate Property Records Does Not Establish an Over Recovery of ICLS and Is Inconsistent with Congressional and FCC Provisions Regarding The Use of Universal Service Support.**

Even if USAC correctly interpreted Part 32 as imbuing it with authority to require PRT to retain and produce specific documents—which it did not—USAC’s allegation that PRT was overpaid ICLS because of its failure to comply with the Commission’s CPR rules is misguided. Under Part 32 of the Commission’s rules, carriers record investment in property, plant, and equipment and maintain certain supporting records, including basic property records. The basic property records consist of the CPRs, which include details concerning specific location, date of

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an audit “is required to sign an assertion letter acknowledging its responsibility for compliance with applicable requirements of FCC rules (e.g., 47 C.F.R. Part 54, Subparts C, D, J and K and Part 36, Subpart F) with respect to disbursements made from the USF”). Notably, the Part 36 rules are irrelevant for purposes of this proceeding. Only subpart F of Part 36 applies to USF. And subpart F relates to calculation of the expense adjustment, not record retention.

<sup>40</sup> 47 C.F.R. § 54.702(c) (emphasis added).

<sup>41</sup> Notably, Part 32 only applies to ILECs. Thus, reading a rigorous document retention requirement into Part 32 (that would apply to conduct before 2008) is arbitrary and capricious because it would create an unlawful regulatory disparity between ILECs and non-ILEC recipients of universal service support. See *Burlington N. & Sante Fe Ry. Co. v. Surface Transp. Bd.*, 403 F.3d 771, 777 (D.C. Cir. 2005).

placement in service, and original cost of plant assets, and supplemental records, which include invoices, work orders, and engineering drawings to support the CPRs.<sup>42</sup> The CPRs “provide data for cost allocations studies used in state regulatory proceedings” and “provide material-only costs for accounting for transfers, reallocations, and adjustments of plant.”<sup>43</sup> These records are not maintained for purposes of high cost universal service support, but instead are primarily used by state regulators “in their local ratemaking processes.”<sup>44</sup>

Even though the CPRs were designed and are intended for ratemaking purposes, USAC determined that PRT’s failure to comply with the CPR rules means that PRT was overpaid ICLS. USAC made this determination based on the auditor’s sample of assets in service as of December 31, 2004 for which the auditor requested supporting documentation. According to the auditor, PRT was unable to provide sufficient supporting documentation for 19 of the 40 assets selected for testing and was only able to provide partial support for 7 of those 40 assets. Based on this sample, the auditor extrapolated (without any explanation) the amount of ICLS it claimed PRT was overpaid of which USAC now seeks recovery.

But USAC’s and its auditor’s conclusions are flawed. First, merely because PRT was unable to provide adequate documentation regarding the assets in question does not mean that these assets are missing or are being used to provide service for which USF subsidies are not

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<sup>42</sup> 47 C.F.R. § 32.2000(e)(3).

<sup>43</sup> *2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2; Amendments to the Uniform System of Accounts for Interconnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Reporting*, Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286, Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, and 80-286, 16 FCC Rcd 19911, ¶ 121 (2001).

<sup>44</sup> *Id.* (seeking comment on eliminating the CPR rules in three years).

intended to support. In fact, neither the audit report nor USAC's Management Response makes any mention of whether PRT is actually using the assets in question.

Second, even if any assets for which PRT was unable to provide sufficient supporting documentation are not in actual service, the only cause is a failure to properly retire the asset. Under the methods of accounting prescribed by the Commission in Part 32, however, the timing of the retirement of assets has no impact on the net investment used to set rates under rate of return regulation (under which PRT was operating prior to July 1, 2008), and certainly has no impact on rates under price-cap regulation. This is so because when plant is retired, there are equal and offsetting entries to the telephone plant in service and accumulated depreciation accounts. "Net Plant," the amount used to establish the rate base under rate-of-return regulation, is unchanged.<sup>45</sup> Thus, even if it could be demonstrated that PRT failed to retire certain assets on a timely basis prior to price cap regulation, such failure would have no impact on rates and should have no corresponding effect on the amount of ICLS PRT receives.

Even beyond the fundamental error of USAC using a failure to comply with CPR requirements as a basis for concluding that PRT was overpaid ICLS, the methodology employed by the auditor to calculate such overpayment was flawed. Specifically, the audit was not designed to test the dollar value of the assets as recorded in the financial accounts. That is, the audit appears to be designed to test whether PRT maintained adequate information regarding the assets sampled (*e.g.*, location, identification number, and quantity) and not whether the dollars attributed to each asset were accurately associated with the asset being used. By using such an approach, the audit was a completely ineffective tool to predict error in the investment accounts

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<sup>45</sup> Financial results, regulated/nonregulated cost allocations, and jurisdictional separations are also based on "net plant." Accordingly, any evaluation of these items would not be affected by the failure to retire assets.

with any degree of certainty, let alone to extrapolate the amount of ICLS that PRT was allegedly overpaid.<sup>46</sup>

The Commission has previously been confronted with similar problems in connection with CPR audits. Specifically, in 1997, the Common Carrier Bureau's auditors began an audit of the CPRs of the Regional Bell Operating Companies ("RBOCs") to determine whether their records were being maintained in compliance with the Commission's rules.<sup>47</sup> In each audit, the Bureau auditors reported that the carrier's CPRs were deficient and did not comply with the Commission's rules and that certain equipment described in the CPRs could not be found by the Bureau auditors or by company personnel during the field audits. The proposed corrective action involved a recommendation that billions in RBOC assets be written off, which was based on a sample to extrapolate allegedly "missing" assets to the investment base.

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<sup>46</sup> It is difficult to tell exactly what the auditor did based on the audit report, and neither the auditor nor USAC provided the underlying calculations used to determine the amount of ICLS that PRT allegedly was overpaid.

<sup>47</sup> *Bell Atlantic (South) Telephone Companies' Continuing Property Records Audit*, Order, 14 FCC Rcd 5541 (rel. March 12, 1999) and *Bell Atlantic (North) Telephone Companies' Continuing Property Records Audit*, Order, 14 FCC Rcd 5855 (rel. March 12, 1999); *BellSouth Telecommunications' Continuing Property Records Audit*, Order, 14 FCC Rcd 4258 (rel. March 12, 1999); *Southwestern Bell Telephone Company's Continuing Property Records Audit*, Order, 14 FCC Rcd 4242 (rel. March 12, 1999); *Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit*, Order, 14 FCC Rcd 4273 (rel. March 12, 1999); *Pacific Bell and Nevada Bell Telephone Companies Continuing Property Records Audit*, Order, 14 FCC Rcd 5839 (rel. March 12, 1999); *US West Telephone Operating Companies' Continuing Property Records Audit*, Order, 14 FCC 5731 (rel. March 12, 1999). In addition, the Bureau auditors had previously conducted a joint Federal-State CPR audit for GTE. See *GTE Telephone Operating Companies, Release of Information Obtained During Joint Audit*, Memorandum Opinion and Order, 13 FCC Rcd 9179 (rel. March 18, 1998).

The RBOCs filed extensive documentation demonstrating the flawed methodology of the CPR audits and unsupportable conclusions based on those audits.<sup>48</sup> In the face of such objections and in light of other regulatory developments, the Commission decided “not to pursue further investigation into the CPR audits and close the proceeding with regard to whether the CPRs reflected assets that were not purchased or used by the RBOCs in accordance with our rules.”<sup>49</sup>

While finding that the RBOCs’ CPRs were not maintained in accordance with its rules, the FCC took no action, other than to “direct the Common Carrier Bureau to work with the RBOCs to evaluate and improve the accuracy of their property records and accounts to ensure compliance with our requirements going forward.”<sup>50</sup> Under the circumstances, and in light of the due process issues discussed above, allowing USAC to recover alleged overpayments of ICLS to PRT based on a sample audit of PRT’s compliance with the Commission’s CPR rules would be unlawful.

Indeed, nothing in Communications Act or FCC rules requires a recipient to use ICLS only for the provision of *facilities*, as USAC and the auditor improperly assumed. To the contrary, Congress and the Commission have made clear that universal service recipients may

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<sup>48</sup> See, e.g., Comments of BellSouth Corporation, CC Docket 99-117, ASD File No. 99-22, at 9-20 (filed Sept. 23, 1999); Comments of Bell Atlantic, CC Docket 99-117, ASD File No. 99-22, at 2-6 (filed Sept. 23, 1999) (arguing that “the audit staff reports are so riddled with flaws that whatever the misguided intent in starting these audits, there is no usable information contained in the reports’ results”).

<sup>49</sup> *1998 Biennial Regulatory Review -- Review of Depreciation Requirements for Incumbent Local Exchange Carriers; Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, et al.; GTE Telephone Operating Companies Release of Information Obtained During Joint Audit*, Second Report and Order in CC Docket No. 99-137 and Order in CC Docket No. 99-117 and AAD File No. 98-26, 16 FCC Rcd 4083, ¶ 12 (2000).

<sup>50</sup> *Id.* at ¶ 13.

use the funding “for the provision, maintenance, and upgrading of facilities *and services* for which the support is intended.”<sup>51</sup> The Commission itself recognized that this anomaly in its rules created a particular problem in the case of competitive ETCs, which are required to submit no cost information whatsoever, and thus asked how it could improve the use to which universal service distribution is put.<sup>52</sup> In other words, even if Part 32 provided USAC authority to demand that USF recipients retain certain facility records, and PRT failed to retain such records, this would not by itself establish an over recovery because the statute and the rules permit a recipient to use the funding for deployment of facilities *or the provision of service*. PRT most certainly used its funding to provide telecommunications services within Puerto Rico.<sup>53</sup> And USAC does not dispute this fact.

**C. USAC’s Audit Goes Well Beyond the Veracity of the Data Provided by PRT as Required by USAC Pursuant to FCC Forms 507, 508, and 509.**

In adopting the ICLS mechanism in 2001, the Commission directed USAC to focus its audits on the information submitted by applicants in the relevant FCC application forms and the required certifications. The Commission emphasized that “to ensure that carriers receiving [ICLS] ... will use that support in a manner consistent with section 254(e), we shall require carriers seeking such support to file a certification with the Commission and the

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<sup>51</sup> See 47 U.S.C. § 254(e); 47 C.F.R. §§54.7 and 54.904(a). Notably, ICLS was adopted so that rate of return incumbent ILECs were compensated through the Universal Service Fund for lowering interstate access charges to interexchange carriers. See *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, 23 FCC 6475, ¶ 177, n. 464 (2008). This is not the case for CETCs that receive this support.

<sup>52</sup> See *High-Cost Universal Service Support (Identical Support Rule) Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking, 23 FCC Rcd 1467, ¶ 26 (2008) (seeking comment on how to strengthen the use certification process for competitive ETCs).

<sup>53</sup> Notably, Section 214(e)(4) compels an ETC to seek state commission permission before it withdraws from providing service.

Administrator.”<sup>54</sup> The Commission then tasked USAC with “perform[ing] audits of beneficiaries of the new [ICLS] mechanism to ensure the *accuracy of data submitted*.”<sup>55</sup>

Notably, the Commission did not direct USAC to investigate—or to force carriers to retain—the additional documentation USAC has required in the instant case.<sup>56</sup> When PRT applied for ICLS in 2004, it fulfilled its requirement to complete FCC Forms 507, 508, and 509 and submit a certification attesting to the accuracy of its filings. And USAC—in reviewing the “accuracy of data submitted”—does not take issue with the veracity of the data provided in PRT’s completed forms and certifications. Given this, USAC’s decision to recover ICLS funding based on PRT’s failure to provide records that it was not required to maintain and that do not establish whether it properly made use of high cost support would be arbitrary and capricious.<sup>57</sup>

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<sup>54</sup> *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 16 FCC Rcd 19613, ¶¶ 162, 176 (2001) (“MAG Order”).

<sup>55</sup> *Id.* (emphasis added).

<sup>56</sup> During 2004, the Part 54 audit rules simply provided USAC with authority to “suspend or delay . . . support amounts provided to a carrier if the carrier fails to provide adequate verification of . . . support amounts provided upon reasonable request.” 47 C.F.R. § 54.707. But this provision did not impose *specific* document retention requirements or mandatory document retention periods that would justify USAC’s decision in the instant case.

<sup>57</sup> In addition to PRT completing accurately the relevant FCC Forms, PRT has been subjected to various audits, none of which called in question the amount or use of ICLS received by PRT. First, the company was subjected to annual audits by outside accounting firms. Second, a Cost Allocation Manual Audit was performed on PRT for the year ended December 31, 2004 pursuant to 47 C.F.R. § 64.904(c). Third, as a member of the NECA Interstate Common Line Pool until June 30, 2008, PRT was subject to ongoing reviews and audits of the company data and calculations by NECA’s auditors.

V. **CONCLUSION**

For the foregoing reasons, the Commission should overrule USAC's decision to seek to recover \$568,540 in ICLS from PRT.

Respectfully submitted,

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